

**LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS**

200 W. Washington, Suite 301
Indianapolis, IN 46204
(317) 233-0696
<http://www.in.gov/legislative>

FISCAL IMPACT STATEMENT

LS 7560

BILL NUMBER: HB 1201

NOTE PREPARED: Jan 7, 2007

BILL AMENDED:

SUBJECT: Income Tax Exemption for Patent Income.

FIRST AUTHOR: Rep. Murphy

FIRST SPONSOR:

BILL STATUS: As Introduced

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: The bill exempts income from taxation that is derived from a qualified patent issued to a taxpayer domiciled in Indiana. It requires that a qualified patent must have resulted from a development process conducted in Indiana. The bill provides that a taxpayer may not claim more than \$1,000,000 in exemptions in a taxable year. It also provides that a taxpayer may not claim an exemption for income derived from a particular qualified patent for more than ten years.

Effective Date: January 1, 2008.

Explanation of State Expenditures: The Department of State Revenue (DOR) will incur additional expenses to revise tax forms, instructions, and computer programs to reflect the new exemption for patent-derived income. The DOR's current level of resources should be sufficient to implement the new exemption.

Explanation of State Revenues: *Summary:* The bill would reduce state Adjusted Gross Income (AGI) Tax or Financial Institutions Tax liabilities of taxpayers that derive income from certain patents issued after December 31, 2007. The potential revenue loss to the state from this exemption is indeterminable and could begin in FY 2009. The maximum exemption a taxpayer may claim in a taxable year is \$1 M. The maximum exemption amount translates into a \$34,000 reduction in tax liability for an individual taxpayer, and an \$85,000 reduction in tax liability for a corporate taxpayer or financial institution. Thus, if 10 taxpayers qualify for the maximum exemption amount each year, the annual revenue loss could range from \$340,000 (if all the taxpayers are individuals) to \$850,000 (if all the taxpayers are corporations or financial institutions).

Background Information: The bill establishes an exemption from the AGI Tax and the Financial Institutions

Tax for certain income derived in the taxable year from “qualified patents” issued to “qualified taxpayers” after December 31, 2007. The exemption applies to the following:

- (1) Income derived from making, using, or selling an invention protected by the qualified patent.
- (2) Royalties received from an assignment or license of the qualified patent.
- (3) Damage awards or settlement proceeds recovered for infringement of the qualified patent.

The aggregate amount of patent-related income a taxpayer may exempt in a taxable year is \$1 M. A taxpayer may claim the exemption with respect to a particular patent for up to 10 years. A “qualified patent” is a patent issued for an invention resulting from a development process conducted in Indiana. A “qualified taxpayer” is a taxpayer domiciled in Indiana.

Since 1995, an average of about 1,500 patents of all types (utility, plant, design, and other patents) have been granted annually to persons or entities in Indiana. However, annual patent totals for Indiana persons or entities have declined in recent years from a high of 1,745 in 2002 to 1,246 in 2005. Data is unavailable describing the typical income generated by patents granted to persons or entities in Indiana.

Since the exemption is effective beginning in tax year 2008, the fiscal impact would begin in FY 2009. Revenue from the corporate AGI Tax and the Financial Institutions Tax is deposited in the state General Fund. The revenue from the AGI Tax on individuals is deposited in the state General Fund (86%) and the Property Tax Replacement Fund (14%).

Explanation of Local Expenditures:

Explanation of Local Revenues: Because the exemption for individuals receiving patent-derived income would decrease taxable income, counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) may, as a result, experience an indeterminable decrease in revenue from these taxes.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties with a local option income tax.

Information Sources: U.S. Patent and Trademark Office, Electronic Information Products Division, <http://www.uspto.gov/web/offices/cio/cis/prodsvc.htm>.

Fiscal Analyst: Jim Landers, 317-232-9869.